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COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

COMMITTEE ON EDUCATION AND THE WORKFORCE

October 18, 2012

The Honorable Mark Mazur
Assistant Secretary for Tax Policy
United States Department of the Treasury
1500 Pennsylvania Avenue North West
Washington, DC 20220

The Honorable Emily S. McMahon
Deputy Assistant Secretary for Tax Policy
United States Department of the Treasury
1500 Pennsylvania Avenue North West
Washington, DC 20220

Dear Secretary Mazur and Secretary McMahon:

I write to request that the U.S. Treasury investigate whether the use of Build America Bonds to finance the development and construction of a coal-fired power plant known as the Prairie State Energy Campus (PSEC) by the owners and developers of the Prairie State Generating Company (PSGC) was a proper use of this subsidy. My office has been investigating the circumstances of this project and its effect on local community ratepayers across Ohio.

Congress' intent was clear in including Build America Bonds as a component of the American Recovery and Reinvestment Act so as to broaden and encourage finance options for state and local governments at a time when economic conditions were unfavorable. However, it appears that rather than assisting state and local governmental entities to obtain financing for public works projects, in this case, the benefit of the subsidy provided by the Build America Bonds has largely gone to a private, multi-national energy firm. Meanwhile, electric utility rate-paying communities in Ohio and seven other states have been saddled with substantial debt to pay for an increasingly expensive project that is of marginal value to them. This scenario is not consistent with the intent of Congress in including Build America Bond subsidy in the American Recovery and Reinvestment Act.

I. Build America Bonds provided a $900 million subsidy for a project that saddled local communities with debt for decades

Peabody Energy sold 95% of its ownership interest in the Prairie State Generating Company to eight power agencies, including American Municipal Power (AMP). In turn, those power agencies convinced their member municipalities and electric co-ops across the Midwest to buy shares of anticipated future power generated by the PSEC project. The municipalities and co-ops have incurred $4.9 billion in known and growing project costs. Collectively, principal and interest owed on bonds issued to date are approximately $11.7 billion. PSGC will receive $900 million worth of direct interest rate subsidies over the life of the bonds from the Build America

Bonds. The debt incurred covers the cost of the plant, the Lively Grove mine and the Jordan Grove ashfill. The Institute for Energy Economics and Financial Analysis (IEEFA) estimates that through their membership in the Ohio branch of AMP, a nonprofit power wholesaler to which Cleveland Public Power belongs, Clevelanders alone are on the hook for $19 million above and beyond what they would have paid had Cleveland Public Power simply bought electricity on the open market. The full project affects 2.5 million ratepayers across eight states.

II. The fact that a private firm made a substantial gain while ratepayers face decades of payments for debt service is only one aspect of a deal that would likely have fallen apart if not for the taxpayer subsidy

Peabody Energy Corporation was the initial developer of the 1,582 MW Prairie State Energy Campus (PSEC) coal-fired power plant. However, beginning as early as 2001, Peabody began an aggressive campaign to offload its risk with promises of long-term low-cost power to induce joint municipal power agencies in states throughout the Midwest to participate in the project. This campaign induced eight power agencies, including AMP, to agree to collectively take on approximately 95 percent of the ownership interest in the project. However, by 2007, as plans for dozens of other coal-fired power plants nationwide were being scrapped, other privately-owned utilities and public power agencies withdrew from the PSEC project and voided their agreements, citing the high risks involved. Peabody now retains only a 5 percent interest in the Prairie State project and has the right to sell even that small ownership share after five years.

The power agencies, in turn, entered into long-term "take-or-pay" contracts, and in some cases, "take-and-pay" contracts, with 217 municipalities and 17 electric coops in Virginia, Ohio, Kentucky, Indiana, Illinois, Michigan, Missouri and West Virginia. Under the take-or-pay contracts, communities are obligated to pay for PSEC whether or not the plant generates any power. Cleveland Public Power and 67 other municipalities signed onto the plant pursuant to their relationship with AMP in Ohio. Under these contracts the utilities' customers will (unwittingly) bear most of the risk of the venture in the event that new costs must be covered. To date, there are fundamental problems with the financial stability and the long-term reliability of the plant which remain unaddressed, resulting in an actual cost of power from the Prairie State Energy Campus which is more than 40 percent higher than the costs that communities were promised when the project was marketed to them.

Already the price of electricity from the plant is far above that promised to communities when they signed on. Even if both unitds of Prairie State reach the highest levels of commercial operation, communities anticipate that power generated by the plant will continue to be more expensive than the going market price for power in the region for the foreseeable future. One recent study put the excess power costs at up to double the originally promised price, which is likely to be underestimated since the plant is reported to be operating at diminished capacity. Initial estimates for the price of power assumed that the plant would be operating at 85% capacity. However, unconfirmed accounts of extended periods of outages in one unit of the plant's operations raise the possibility that the plant is operating at substantially less than 85% capacity.

Furthermore, it is likely that the financial weaknesses of the proposed plant were well known to Peabody and PSGC as it developed the project and then sold to power agencies and local utilities. It was widely known that new coal plants were a bad financial risk. Peabody and AMP both canceled plans to build other coal plants because of rising costs between 2004 and the present. The cost of PSEC rose from $1.7 billion to its current price of $4.9 billion during this period. PSGC rejected warnings from government financial officers, consultants, and others about the rising costs.

The increase in the price of electricity from the plant is driven largely by massive increases in the capital costs of the plant, including the mine and ashfill. The plant has already suffered from construction defects which caused a major delay in opening one of the units, and IEEFA's report found that it is apparently suffering from additional operational problems. The debt and debt service on the plant will now be a permanent part of the increased price of electricity charged to consumers. This is particularly disturbing in light of the fact that AMP and the Treasury Department were warned about the high financial and environmental risks of coal-fired power plant construction in a 2008 letter by then-New York City Comptroller William Thompson[1]. This warning was brushed aside by AMP and others, but the consequences of the risks identified by Comptroller Thompson and others at the time are now borne by the communities who are saddled with this growing liability.

Peabody's representations regarding the quality of the permits issued for the ashfill are questionable, and its poor management of the ashfill is driving up costs. The plant and project were sold to communities by Peabody Energy as part of a package which included the Jordan Grove ashfill, a "permitted" site. The site came with a purported 23 year useful life. IEEFA's report found that upon investigation, PSGC learned that the ashfill had a useful life of only 12 years. PSGC has purchased a new site and is currently in the permit review process. The cost of full and complete ashfill capacity is not currently known but is part of the cost of PSGC's electricity that will be passed on to customers.

III. Struggling communities were promised low cost power but are instead being forced to behave as energy traders

The current market for power is producing electricity at prices far below that of the Prairie State plant. While the plant was supposed to be a hedge against high prices, it is now a source of upward pressure on prices. Rather than an asset that can help keep electricity prices down, it is a liability that makes publicly-provided power less competitive. Communities that should be benefitting in the form of lower rates, improved services or financial relief are now pressed to use, market and sell expensive electricity at a loss, and the damage is already being experienced. One example is Batavia, Illinois, which recently announced it has no choice but to re-sell almost all of its electricity from the Prairie State project on the market. Batavia, like many other municipalities, is contractually obligated to purchase power from the PSEC project and it will likely experience losses from that sale. This is because even though Batavia was promised low rates for the power, it and dozens of other municipalities are finding that the price is far higher, while the need for the power produced is far less than was predicted.

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[1] Available at: http://prairiestatecoalplant.org/wp-content/uploads/2012/05/PSEC.tresthomps.2008.pdf.

We do not yet know how long Batavia and other municipalities who are part of the PSEC project will experience losses and at what level. Though the purpose of these tax exempt bonds was not to turn small local governments into high risk energy trading operations like Enron, it appears that municipalities like Batavia have no choice. Today, while communities like Batavia are in near-crisis in trying determine how they will pay for some of the highest-priced power in the country, Peabody is shielded from any risk to its credit quality and immune from the struggle to provide revenue sufficient to pay for billions of dollars in outstanding debt.

Further, earlier this year communities throughout the Midwest have been saddled with bills from the Prairie State plant to pay for electricity they have never received. Local systems were paying hundreds of thousands per month out of reserves for electricity not received and then buying actual electricity on the market at additional costs. Cleveland, for example, paid $250,000 per month in March, April, and May of this year for debt service with no electricity received.

These facts, along with the fact that Build America Bonds have financed such a large part of the costs of the project at a time when private firms rejected such investments raises troubling questions about the use of this subsidy, about whether Congress' intent was followed, and whether Internal Revenue Service regulations are being followed. This is not simply a question of investigating a "bad investment." It is about an inappropriate use of taxpayer dollars which are then used to saddle consumers with higher utility rates. I ask that your office conduct a thorough review and inform me of the outcome.

My staff and I stand ready to assist in any way possible to ensure the protection of ratepayers.

Sincerely,

Dennis J. Kucinich

Dennis J. Kucinich
Member of Congress